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CIRCUITS SPLIT ON THE ELEMENTS OF WILLIAMS ACT "MANIPULATION"—VALIDITY OF TENDER OFFER DEFENSES UNCERTAIN

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I. INTRODUCTION

The most significant tactical development of the last twenty years in the corporate takeover arena is the emergence of the cash tender offer as the favorite weapon of takeover bidders. With devastating suddenness, a hostile tender offeror can overrun a target corporation, capturing voting control of the company in a matter of weeks. The key to the effectiveness of the cash tender offer is that it allows the offeror to acquire the target corporation directly from its shareholders, thereby rendering the target's management powerless to resist the takeover.

The ubiquitous spectre of the cash tender offer as a potential threat to the ascendancy of the incumbent managers of virtually all public corporations has prompted directors of many companies to devise methods of defense against hostile tender offers. Recent years have seen the deployment of a wide array of innovative tender offer defenses by target companies, and by companies seeking to discourage prospective tender offerors. These new defensive strategies have increased significantly the duration, intensity and costliness of tender offer struggles.

As the ferocity and expense of these battles have continued to escalate, they increasingly have spilled over into the courts, as bloodied combatants challenge the legality of their opponents' tactics. The rapidly proliferating arsenal of tender offer defensive weaponry has been the subject of much of this recent litigation. Most of the challenges to the validity of tender offer defensive measures have been raised in federal court under the Williams Act,¹ the federal statute which regulates tender offers.

Recently, a dispute has arisen as to the interpretation of the key antifraud provision of the Act.² The Courts of Appeals have split on

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1. 15 U.S.C. §§ 781(i), 78m(d), (e), 78n(d), (e), (f) (1982).

2. 15 U.S.C. § 78n(e) (1982). This section prohibits "fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any

the meaning of "manipulative acts" as contained in Section 14(e) of the Act.³ The Second and Third Circuits have held that the ban on "manipulative acts" in Section 14(e) is directed only at conduct involving misrepresentation or nondisclosure in connection with a tender offer.⁴ The Second and Third Circuits have specifically rejected⁵ the Sixth Circuit's holding that Section 14(e) "manipulation" includes any action which disturbs the competitive balance among the parties to a tender offer, regardless of misrepresentation or nondisclosure.⁶

This article will discuss the competing interpretations of Section 14(e), and analyze the arguments in support of each. The analysis will contrast the decisions of the Second Circuit in *Buffalo Forge Company v. Ogden Corporation*,⁷ and the Third Circuit in *Schreiber v. Burlington Northern, Inc.*,⁸ which found misrepresentation or nondisclosure to be required elements of Section 14(e) "manipulation",⁹ with the Sixth Circuit's holding in *Mobil Corporation v. Marathon Oil Company*¹⁰ that Section 14(e) can be violated without misrepresentation or nondisclosure.¹¹ An examination of the bases of these three decisions, other judicial interpretations of Section 14(e), and the purpose of the Williams Act shows that *Buffalo Forge* and *Schreiber* correctly interpret "manipulation" under Section 14(e).

II. THE TENDER OFFER SETTING

The cash tender offer has proven to be a highly effective method of taking over a corporation. A tender offer is simply an offer to purchase stock at a premium made directly to the shareholders of a corporation. If the holders of a controlling percentage of the target company's stock accept the offer, or "tender" their shares, the tender offeror obtains control of the corporation.¹² The speed and efficiency of this process has

solicitation of security holders in opposition to or in favor of any such offer, request, or invitation."

3. *Id.*

4. *Buffalo Forge Co. v. Ogden Corp.*, 717 F.2d 757 (2d Cir. 1983), *cert. denied*, 104 S. Ct. 550 (1984); *Schreiber v. Burlington Northern, Inc.*, 731 F.2d 163 (3d Cir.), *cert. granted*, 53 U.S.L.W. 3204 (Oct. 2, 1984).

5. 717 F.2d at 760; 731 F.2d at 166.

6. *Mobil Corp. v. Marathon Oil Co.*, 669 F.2d 366 (6th Cir. 1981).

7. 717 F.2d 757 (2d Cir. 1983), *cert. denied*, 104 S. Ct. 550 (1984).

8. 731 F.2d 163 (3d Cir.), *cert. granted*, 53 U.S.L.W. 3204 (Oct. 2, 1984).

9. 717 F.2d at 760, 731 F.2d at 166.

10. 669 F.2d 366 (6th Cir. 1981).

11. *Id.* at 377.

12. For background on the various methods of executing and resisting corporate takeovers, see E. ARANOW, H. EINHORN & G. BERLSTEIN, *DEVELOPMENTS IN TENDER OFFERS FOR CORPORATE CONTROL* (1977); P. DAVEY, *DEFENSE AGAINST UNNEGOTIATED CASH TENDER OFFERS*

made the tender offer extremely popular among takeover bidders seeking fast and simple acquisitions.

The ease by which control of a company can be acquired through the tender offer device exposes corporate managers to the constant threat of a takeover of their company by a bidder who, upon gaining control, may dispense with their services. Understandably, managers of target corporations have developed methods of resisting tender offers by persons hostile to their interests. These defensive measures are designed to resist tender offers altogether, or in the alternative, to secure a takeover by someone friendly to the target management.¹³

One of the most common and effective of these defensive tactics is the "lock-up" arrangement.¹⁴ This arrangement seeks to defeat a tender offeror hostile to target management by ensuring the success of a friendly bidder, or "White Knight."¹⁵ Lock-ups usually take the form of a grant of stock or asset purchase options to the favored bidder.¹⁶ The dual effect of such options is to give the White Knight an advantage in the bidding contest for the target company and make the target unattractive to the hostile bidder.¹⁷

The legality of tender offer defenses, including lock-up arrangements, has been challenged in many recent cases.¹⁸ The usual claim in these cases has been that the defensive measure is barred by the Williams Act.¹⁹ This claim is based on the assertion that the defensive measure is a "manipulative practice" prohibited by Section 14(e) of the Act.²⁰ Thus, judicial interpretations of the purpose and meaning of the Williams Act, particularly Section 14(e), have a profound impact on the ability of corporate managers to resist tender offers.

(1977); M. LIPTON & E. STEINBERGER, TAKEOVERS & FREEZEOUTS (1978); A. FLEISCHER, TENDER OFFERS: DEFENSES, RESPONSES AND PLANNING (1983).

13. See Note, *Developments in Corporate Takeover Techniques: Creeping Tender Offers, Lockup Arrangements and Standstill Agreements*, 39 WASH. & LEE L. REV. 1095, 1108 (1982).

14. *Id.*

15. *Id.*

16. *Id.*

17. *Id.*

18. See *Mobil Corp. v. Marathon Oil Co.*, 669 F.2d 366 (6th Cir. 1981); *Martin-Marietta Corp. v. Bendix Corp.*, 549 F. Supp. 623 (D. Md. 1982); *Atchley v. Qonaar Corp.*, 704 F.2d 355 (7th Cir. 1983); *Buffalo Forge Co. v. Ogden Corp.*, 717 F.2d 757 (2d Cir. 1983), *cert. denied*, 104 S. Ct. 550 (1984).

19. See cases cited *supra* note 18.

20. E.g., *Mobil Corp. v. Marathon Oil Co.*, 669 F.2d 366 (6th Cir. 1981); *Buffalo Forge v. Ogden Corp.*, 717 F.2d 757 (2d Cir. 1983), *cert. denied*, 104 S. Ct. 550 (1984).

III. THE CONFLICTING INTERPRETATIONS OF SECTION 14(E)

A. *The Sixth Circuit Viewpoint*

In *Mobil Corporation v. Marathon Oil Company*²¹ the Sixth Circuit attributed a broad purpose to the Williams Act.²² Breaking with previous constructions,²³ the *Mobil* court held that the Act requires more than full disclosure by the parties to a tender offer, and that "manipulation" under Section 14(e) can occur without misrepresentation or non-disclosure.²⁴ Furthermore, the Sixth Circuit held that the Williams Act requires that all tender offerors be allowed to compete on equal terms for shares in the target company.²⁵

The case involved a challenge to the validity under Section 14(e) of defensive measures taken by Marathon Oil Company to ward off a takeover by Mobil Corporation.²⁶ In order to defeat Mobil's tender offer of \$85 per share for a majority of Marathon stock, Marathon's directors solicited a tender offer from United States Steel.²⁷ In exchange for U.S. Steel's tender offer of \$125 per share for a majority of Marathon's stock, Marathon granted U.S. Steel an option to purchase ten million unissued Marathon shares for \$90 each, and an option to purchase Marathon's "crown jewel", an interest in the Yates oil field.²⁸ The Yates field option could be exercised only if U.S. Steel's tender offer failed, and another party acquired Marathon.²⁹ Mobil filed an action seeking to enjoin these options as "manipulative devices" under Section 14(e).³⁰

The Sixth Circuit held that the options were "manipulative"

21. 669 F.2d 366 (6th Cir. 1981).

22. *Id.* at 376-77.

23. See *Piper v. Chris-Craft Indus., Inc.*, 430 U.S. 1, *reh'g denied*, 430 U.S. 976 (1977).

24. 669 F.2d at 377. The Sixth Circuit stated: "In short, to find compliance with section 14(e) solely by the full disclosure of a manipulative device as a *fait accompli* would be to read the 'manipulative acts and practices' language completely out of the Williams Act." *Id.*

25. *Id.* at 376. No court had ever before construed the Williams Act as a mechanism to ensure that competing tender offerors have equal standing in the battle for control.

26. *Id.* at 368. *Mobil* generated a great deal of scholarly comment, most of it unfavorable. See Note, *Tender Offers, Lock-ups and the Williams Act: A Critical Analysis of Mobil Corp. v. Marathon Oil Co.*, 21 DUQ. L. REV. 669 (1983); Note, *Tender Offer Defensive Tactics—Federal Regulation of Management's Prerogative*, 10 FORDHAM URB. L.J. 633 (1982); Note, *The Future of Lock-ups After Mobil v. Marathon Oil*, 27 ST. LOUIS U.L.J. 261 (1983); Note, *Swallowing the Key to Lock-up Options: Mobil Corp. v. Marathon Oil Co.*, 14 U. TOL. L. REV. 1055 (1983); but see Weiss, *Defensive Responses to Tender Offers and the Williams Act's Prohibition Against Manipulation*, 35 VAND. L. REV. 1087 (1982); Comment, *Takeover Developments—Defining "Tender Offer" and "Manipulation" Under the Williams Act*, 40 WASH. & LEE L. REV. 1199 (1983).

27. 669 F.2d at 367.

28. *Id.*

29. *Id.*

30. *Id.* at 368.

within the meaning of Section 14(e).³¹ In reaching this conclusion, the court held that Section 14(e) "manipulation" includes all conduct which "artificially affects" the price of a target company's stock.³² The court supported this broad construction partially on the grounds of the Supreme Court's statement in *Santa Fe Industries, Inc. v. Green*,³³ that the federal securities laws are meant to "prohibit the full range of ingenious devices that might be used to manipulate securities prices."³⁴ The only other support *Mobil* offered for its broad interpretation of "manipulation" was a case interpreting the term as used in the Commodities Exchange Act.³⁵

Applying its broad reading of the Williams Act to the case before it, the Sixth Circuit found that the Yates field purchase option created an illegal "artificial ceiling" on the price of Marathon stock at the level of the U.S. Steel offer.³⁶ According to the court, no other tender offeror would seek to top U.S. Steel's bid, because a rival bidder would not be able to obtain Marathon's interest in the oil field.³⁷ Similarly, the stock purchase option was "manipulative" because it enabled U.S. Steel to obtain control of Marathon at a lower cost than could a competing tender offeror.³⁸ The court concluded that the options deterred competing tender offers for Marathon, thereby "artificially affecting" the price of Marathon stock.³⁹ The Sixth Circuit held that this "artificial effect" rendered the options invalid as "manipulative acts" under Section 14(e), regardless of the absence of any misrepresentation or non-disclosure in connection with the options.⁴⁰

The *Mobil* court's invalidation of the lock-up clearly was motivated by its perception that the options were unfair to the Marathon stockholders.⁴¹ The court pointed out that, by deterring competing tender offers, the options forced shareholders to choose between

31. *Id.* at 374.

32. *Id.* (citing *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, *reh'g denied*, 425 U.S. 986 (1976)).

33. 430 U.S. 462 (1977).

34. *Id.* at 477.

35. 669 F.2d at 374 (citing *Cargill, Inc. v. Hardin*, 452 F.2d 1154 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972)). *Cargill* held that "manipulation" in the commodities context means "conduct . . . which has resulted in a price which does not reflect basic forces of supply and demand." 452 F.2d at 1163. The use of a commodities case shows the weakness of the *Mobil* reasoning, as it is inconsistent with the passage from *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, *reh'g denied*, 425 U.S. 986 (1976), cited in *Mobil*, which holds that "manipulation" has a unique meaning in connection with securities activities. 425 U.S. at 199.

36. 669 F.2d at 375.

37. *Id.*

38. *Id.*

39. *Id.*

40. *Id.*

41. *Id.* at 376-77. No other motivation for the *Mobil* decision is apparent in the opinion.

tendering their shares up front to U.S. Steel at \$125 per share, or "being relegated to the 'back end' " of USS's takeover proposal and receiving only \$90 per share.⁴² Indeed, the sole basis for the court's displeasure with the "artificial effect" of the options was that they precluded the shareholders from obtaining a better price from putative competing tender offerors.⁴³

Despite unequivocal Supreme Court precedent to the effect that complaints by shareholders about the fairness of corporate transactions are really allegations of breaches of state law fiduciary duties,⁴⁴ the *Mobil* court insisted that the claim was cognizable under the Williams Act.⁴⁵ Although the court found the options to be violative of Section 14(e), it refused to address the question of whether or not the Marathon directors had breached their fiduciary duties in granting the options.⁴⁶ The court held that the Section 14(e) breach lay not in the grant of the options by Marathon, but in the "demand" for the options by U.S. Steel.⁴⁷ This somewhat awkward conclusion perhaps can be attributed to the court's displeasure with the fact that U.S. Steel conditioned its offer on the grant of the lock-up options.⁴⁸

B. *The Second Circuit Response to Mobil*

The Second Circuit recently adopted a view of the purpose of the Williams Act and an interpretation of Section 14(e) "manipulation" diametrically opposed to the Sixth Circuit position. In *Buffalo Forge Company v. Ogden Corporation*,⁴⁹ the Second Circuit was called upon to review the permissibility under Section 14(e) of tender offer defenses virtually identical to those held illegal in *Mobil*.⁵⁰ Despite the similarity of the challenged tactics to the options invalidated in *Mobil*, the Second Circuit refused to follow *Mobil* in deciding *Buffalo Forge*.⁵¹ Instead, the Second Circuit adhered to a narrower interpretation of the Williams Act which allows more leeway for target defenses.⁵²

42. *Id.* at 377.

43. *Id.* at 376-77. The court ignores the fact that the options attracted an offering price for Marathon stock \$40 per share higher than the only previous bid, Mobil's offer of \$85 per share.

44. *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 478 (1977).

45. 669 F.2d at 374.

46. *Id.*

47. *Id.* at 377. The court offers no reasoning for its refusal to hold the Marathon directors liable for their participation in the lock-up arrangement.

48. *See id.*

49. 717 F.2d 757 (2d Cir. 1983), *cert. denied*, 104 S. Ct. 550 (1984).

50. *Id.* at 758-59.

51. *Id.* at 760.

52. *See id.* Essentially, the Second Circuit held that Section 14(e) prohibits only misrepresentation or nondisclosure in connection with a tender offer. *Id.*

The *Buffalo Forge* litigation arose from the battle between two tender offerors for control of the Buffalo Forge Company.⁵³ The contest for control of Buffalo Forge began when Ampco-Pittsburgh Corporation (Ampco) made a tender offer of \$25 per share for any and all outstanding shares of Buffalo Forge common stock.⁵⁴ After considering this offer, the Board of Directors of Buffalo Forge concluded that it was financially inadequate and contrary to the best interests of Buffalo Forge and its shareholders.⁵⁵ After an unsuccessful attempt to obtain an injunction against the Ampco tender offer, the directors initiated a search for a more attractive tender offer.⁵⁶

The Buffalo Forge directors were able to persuade Ogden Corporation to make a competing tender offer of \$32.75 per share for Buffalo Forge.⁵⁷ In order to secure the Ogden bid, the directors agreed to sell Ogden 425,000 shares of Buffalo Forge treasury stock for \$32.75 per share, to be paid for by a 10-year, nine percent note.⁵⁸ The directors also granted Ogden a one-year option to purchase an additional 143,400 Buffalo Forge treasury shares on similar terms.⁵⁹

The Ogden tender offer touched off a bidding war between Ogden and Ampco for Buffalo Forge stock, which Ampco ultimately won with an offer of \$37.50 for any and all shares.⁶⁰ Upon completing the purchase of a majority of the stock of Buffalo Forge, Ampco obtained the resignations of the Buffalo Forge directors.⁶¹ Subsequently, Ampco merged Buffalo Forge into a wholly-owned subsidiary of Ampco.⁶²

After taking control of Buffalo Forge, Ampco refused to honor the stock purchase and option agreements entered by Buffalo Forge and Ogden.⁶³ Ampco withheld dividends on the 425,000 shares of stock purchased by Ogden, and would not allow Ogden to exercise its option to purchase the remaining 143,400 treasury shares.⁶⁴ Ampco sought rescission of the agreements in federal district court, contending that the stock sale and option were "manipulative devices" under Section 14(e)

53. *Buffalo Forge Co. v. Ogden Corp.*, 555 F. Supp. 892 (W.D.N.Y. 1983), *aff'd*, 717 F.2d 757 (2d Cir. 1983), *cert. denied*, 104 S. Ct. 550 (1984).

54. *Id.* at 897.

55. *Id.* at 898.

56. *Id.*

57. *Id.* at 901.

58. *Id.*

59. *Id.*

60. *Id.* at 903.

61. *Id.*

62. *Id.*

63. *Id.*

64. *Id.*

of the Williams Act.⁶⁵ The district court rejected this contention,⁶⁶ and Ampco appealed to the Second Circuit.⁶⁷

The Second Circuit affirmed the district court's finding that the attempted lock-up of the Buffalo Forge-Ogden acquisition was not a "manipulative device" under Section 14(e).⁶⁸ The court held that the only purpose of the Williams Act is to provide stockholders with all the information they need in order to make an informed decision when faced with a tender offer for their stock.⁶⁹ Therefore, the court stated that "an essential ingredient" of a violation of Section 14(e) is misrepresentation, which it defined as the "omission or misstatement of material facts."⁷⁰ Under this interpretation of Section 14(e), the court found that the full and accurate disclosure of the stock sale and option agreements satisfied the statute.⁷¹

The Second Circuit specifically rejected the Sixth Circuit's expansive reading of the Williams Act.⁷² The *Buffalo Forge* court called the *Mobil* use of Section 14(e) to ban fully disclosed lock-up agreements an "unwarranted extension of the Williams Act."⁷³ The court pointed out that the *Mobil* decision was based on the Sixth Circuit's concern with the substantive fairness of the Mobil tender offer, a consideration not reached by the Williams Act.⁷⁴ Holding that the *Mobil* court exceeded the mandate of the Williams Act, the Second Circuit emphasized that the Supreme Court has declared the Act to be purely a disclosure statute unconcerned with the substantive fairness of tender offers.⁷⁵

C. The Third Circuit Position

In *Schreiber v. Burlington Northern, Inc.*,⁷⁶ the Third Circuit endorsed the *Buffalo Forge* view that Section 14(e) prohibits only conduct

65. *Id.* at 896.

66. *Id.* at 905-06.

67. *Buffalo Forge Co. v. Ogden Corp.*, 717 F.2d 757 (2d Cir. 1983), *cert. denied*, 104 S. Ct. 550 (1984).

68. *Id.* at 759.

69. *Id.* at 760 (citing *Rondeau v. Mosinee Paper Corp.*, 422 U.S. 49 (1975); *Piper v. Chris-Craft Indus., Inc.*, 430 U.S. 1, *reh'g denied*, 430 U.S. 976 (1977)).

70. *Id.* (citing *Lewis v. McGraw*, 619 F.2d 192 (2d Cir.), *cert. denied*, 449 U.S. 951 (1980), *Chris-Craft Indus., Inc. v. Piper Aircraft Corp.*, 480 F.2d 341 (2d Cir.), *cert. denied*, 414 U.S. 910 (1973); *Atchley v. Qonaar Corp.*, 704 F.2d 355 (7th Cir. 1983); *Panther v. Marshall Field & Co.*, 646 F.2d 271 (7th Cir.), *cert. denied*, 454 U.S. 1092 (1981)).

71. *Id.*

72. *Id.*

73. *Id.*

74. *Id.*

75. *Id.*, quoting *Piper v. Chris-Craft Indus., Inc.*, 430 U.S. 1, 28, *reh'g denied*, 430 U.S. 976 (1977).

76. 731 F.2d 163 (3d Cir.), *cert. granted*, 53 U.S.L.W. 3204 (Oct. 2, 1984).

involving misrepresentation or nondisclosure. The case arose from Burlington Northern's bid for control of the El Paso Gas Company.⁷⁷ The acquisition attempt began with a Burlington tender offer for 25.1 million shares of El Paso at \$24 per share.⁷⁸ Despite efforts by the El Paso management to resist the takeover, El Paso shareholders tendered the full 25.1 million shares sought by Burlington.⁷⁹

Rather than taking up the shares tendered, Burlington Northern negotiated a friendly takeover agreement with El Paso management.⁸⁰ Pursuant to this agreement, Burlington rescinded its original tender offer, replacing it with a new offer of \$24 per share for only 21 million shares.⁸¹ This second offer generated tenders of over 40 million El Paso shares.⁸²

Because the number of shares tendered in response to the second offer far exceeded the 21 million shares Burlington had agreed to purchase, each tendering shareholder was able to sell only a portion of his or her shares at the tender offer price.⁸³ As a result of this proration, the shareholders who had tendered in response to the original tender offer realized a significantly lower return than they would have if Burlington had bought the 25.1 million shares originally tendered in accordance with the terms of the first offer.⁸⁴ One of these original tenderors brought suit against Burlington, alleging that the withdrawal of the first tender offer was a "manipulative act" under Section 14(e).⁸⁵

Acknowledging the division of authority among the circuits on the elements of Section 14(e) "manipulation,"⁸⁶ the *Schreiber* court adopted the Second Circuit's position that misrepresentation is essential to a Section 14(e) violation.⁸⁷ Because no misrepresentation or nondisclosure was involved in Burlington's withdrawal of the original tender offer, the court held that there had been no violation of Section 14(e).⁸⁸ The court held that the narrow purpose of the Williams Act

77. *Id.* at 164.

78. *Id.*

79. *Id.*

80. *Id.*

81. *Id.* at 165.

82. *Id.*

83. *Id.* When a tender offer is oversubscribed in this manner, the Williams Act requires that the tender offeror purchase shares on a pro rata basis from all those who have tendered. 15 U.S.C. § 78n(d)(6) (1982).

84. 731 F.2d at 165.

85. *Id.*

86. *Id.*

87. *Id.*

88. *Id.* at 166.

justified this narrow construction of Section 14(e).⁸⁹ Explaining that the Williams Act is designed to provide disclosure of relevant information to investors faced with a tender offer,⁹⁰ the Court pointed out that *Mobil's* extension of Section 14(e) to matters unrelated to disclosure would embroil the federal courts in disputes over the substantive fairness of tender offers.⁹¹ The court recognized that the resolution of such disputes was reserved to the states, and refused to follow *Mobil's* expansive interpretation of Section 14(e).⁹²

IV. ANALYSIS OF THE DIFFERING INTERPRETATIONS OF SECTION 14(e)

In order to determine the proper role of Section 14(e), it is necessary to analyze the competing interpretations of the provision at three levels. Initially, an examination of the basic goals of the federal securities laws facilitates an evaluation of the doctrinal soundness of the conflicting constructions of Section 14(e). At the second level of inquiry, the validity of the arguments in support of each interpretation is assessed in terms of the specific goals of the Williams Act. Finally, the dispute over the meaning of the term "manipulation" as used in Section 14(e) is resolved through a review of previous interpretations of the term in the context of the securities laws.

A. *The Basic Principles and Goals of the Securities Laws*

The basic purpose of the federal securities laws is to protect investors against fraud and to ensure the integrity of the securities markets through the implementation of a "philosophy of full disclosure" in securities transactions.⁹³ Although Congress has enacted a comprehensive body of legislation to achieve this goal, the securities laws override state corporate law only to the extent necessary to effect this policy of disclosure.⁹⁴ The disclosure requirements of federal law operate concurrently with the traditional power of the states to charter corporations and establish substantive standards of corporate management.⁹⁵

89. *Id.*

90. *Id.*

91. *Id.*

92. *Id.*

93. *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 477-78 (1977).

94. *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ware*, 414 U.S. 117, 137 (1973).

95. *Cort v. Ash*, 422 U.S. 66 (1975). There, the Supreme Court held that:

Corporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that, except where federal law expressly requires certain responsibilities of directors with respect to stockholders, state law will govern the internal affairs of the corporation.

Recently, a series of federal court decisions under the antifraud provisions of the securities laws seriously eroded the barrier between the state and federal realms of corporate regulation. Through a broad interpretation of Section 10(b)⁹⁶ of the Securities Exchange Act of 1934, the courts expanded federal law into matters previously thought to be within the exclusive purview of the states.⁹⁷ Although Section 10(b) is designed only to prohibit fraud in the "purchase or sale" of securities,⁹⁸ federal courts over a fifteen-year period extended the provision to reach conduct essentially amounting to corporate mismanagement.⁹⁹ Gradually, the requirement that a Section 10(b) plaintiff be a purchaser or seller of securities seemed to disappear, as the federal courts took cognizance of complaints which were, in reality, allegations that corporate directors had engaged in self-dealing and breach of fiduciary duty.¹⁰⁰ Traditionally, such misconduct had been redressed in a state law action.¹⁰¹

Typically, the activity complained of in these suits was a decision by corporate directors to issue stock to themselves or to majority shareholders at a price minority shareholders deemed inadequate.¹⁰² The

Id. at 84.

96. Section 10(b) provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or any facility of any national securities exchange—

* * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. 78j(b) (1982). In order to effectuate this prohibition, the SEC promulgated Rule 10b-5, which makes it unlawful:

* * *

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security. 17 C.F.R. 240.10b-5 (1984).

97. See *Ruckle v. Roto American Corp.*, 339 F.2d 24 (2d Cir. 1964); *Pappas v. Moss*, 393 F.2d 865 (3d Cir. 1968); *Schoenbaum v. Firstbrook*, 405 F.2d 215 (2d Cir. 1968), *cert. denied*, 395 U.S. 906 (1969); *Shell v. Hensley*, 430 F.2d 819 (5th Cir. 1970); *Superintendent of Insurance v. Bankers Life & Cas. Co.*, 404 U.S. 6 (1971).

98. See *supra* note 96.

99. See cases cited *supra* note 97.

100. See *supra* note 97.

101. See *Hazen, Corporate Mismanagement and the Federal Securities Act's Antifraud Provisions: A Familiar Path with Some New Detours*, 20 BOSTON COLL. L. REV. 819 (1979).

102. Corporate directors generally have full discretion as to the issuance of authorized stock. Absent fraud, their judgment as to the value of consideration received for the stock is deemed

plaintiffs in such cases were usually minority shareholders claiming that these self-dealing transactions were fraudulent within the meaning of Section 10(b).¹⁰³ Although these plaintiffs were neither purchasers nor sellers of securities, the courts held that minority shareholders could sue derivatively under Section 10(b) on behalf of the corporation, which was held to be the "seller" of the securities for purposes of Section 10(b).¹⁰⁴

Even though the circumstances, terms and conditions of the self-dealing transactions were fully disclosed to those who held the power within the corporation to approve the sale of stock, deception of minority shareholders as to these transactions was judicially imputed to the corporation.¹⁰⁵ Thus, a fraudulent sale of securities under Section 10(b) had occurred, despite the lack of deception of those who functioned as the decisionmakers in the sale on behalf of the corporate "seller."¹⁰⁶ This use of Section 10(b) seems wholly unrelated to the federal goal of providing full disclosure for the benefit of those involved in securities transactions. The real wrong which occurred in these cases was not a fraudulent securities transaction, but a breach of the state law duty of directors to manage corporations for the benefit of all shareholders.¹⁰⁷

Perhaps the most expansive reading of Section 10(b) came in *Superintendent of Insurance of New York v. Bankers Life and Casualty Co.*,¹⁰⁸ where the Supreme Court held that a corporation could be deceived within the meaning of 10b-5 even where the sole shareholder and the lone officer of the corporation were participants in the decep-

conclusive, as is their determination of the proper price at which to issue the stock. ABA-ALI MODEL BUSINESS CORP. ACT §§ 16-19 (1980).

103. See 393 F.2d at 866; 405 F.2d at 218.

104. 393 F.2d at 869; 405 F.2d at 219-20.

105. 393 F.2d at 869; 405 F.2d at 219-20. In *Pappas*, the directors of a corporation issued stock to themselves at an allegedly deflated price. 393 F.2d at 866. As majority shareholders, the directors then ratified the issuance. *Id.* at 867. In *Schoenbaum*, the directors of a majority-owned subsidiary voted to issue stock to the parent corporation on the eve of an oil discovery which increased the value of the subsidiary's stock. 405 F.2d at 218. The minority shareholders alleged that the price paid by the parent was inadequate, and that the directors knew of the impending oil discovery at the time they approved the sale. *Id.*

106. 393 F.2d at 869; 405 F.2d at 219-20. The *Schoenbaum* court held that where a controlling shareholder extracts a benefit from the corporation at the expense of the minority, and deceives the minority with regard to such action, the controlling shareholder has violated 10b-5. 405 F.2d at 219-20. State law traditionally regulated such transactions, imposing on controlling shareholders a duty to treat minority shareholders fairly in the exercise of corporate powers. See *Zahn v. Transamerica Corp.*, 162 F.2d 36 (3d Cir. 1947); *Jones v. H.F. Ahmanson & Co.*, 1 Cal. 3d 93, 460 P.2d 464, 81 Cal. Rptr. 592 (1969); *Singer v. Magnavox Co.*, 380 A.2d 969 (Del. 1977).

107. See *Zahn*, *Jones*, *Singer*, *supra* note 106.

108. 404 U.S. 6 (1971).

tion.¹⁰⁹ In *Banker's Life*, the sole shareholder rigged a sale of securities by the corporation so as to deprive the corporation of the proceeds of the sale.¹¹⁰ Finding that the corporation had been "duped" into believing that it would receive the proceeds of the sale, the Court held that creditors injured by this deception had standing under 10b-5 to sue those involved in the scheme.¹¹¹

The Court based this grant of standing to creditors of the "deceived" corporation on the fiduciary duty owed by a controlling shareholder to creditors of the corporation.¹¹² Acknowledging that this is a state law duty ordinarily enforced in state courts, the Court held that a 10b-5 action would lie where the breach of duty took the form of a sale of securities "touched by fraud."¹¹³ Disregarding the fact that the plaintiff was not defrauded in the actual securities transaction, the Court held that a 10b-5 claim would be heard in all such cases, regardless of the availability of a state law remedy.¹¹⁴

The *Banker's Life* implication that a mere breach of fiduciary duty creates a cause of action under Section 10(b) led to further incursions by lower courts into areas of corporate conduct previously governed by state law.¹¹⁵ In *Chris-Craft Indus., Inc. v. Piper Aircraft Corp.*,¹¹⁶ the Second Circuit held that Section 14(e) of the Williams Act incorporated the common-law tort of interference with prospective economic advantage.¹¹⁷ Therefore, the court allowed a defeated tender offeror to recover damages from a target company which had thwarted the tender

109. *Id.* at 9-10.

110. *Id.*

111. *Id.* at 12.

112. *Id.*

113. *Id.*

114. *Id.* at 12-13. The continued validity of this aspect of *Bankers Life* is questionable after the Court's decision in *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462 (1977), which is discussed *infra*, at notes 129-38 and accompanying text, and in view of the Court's holding in *Cort v. Ash*, 422 U.S. 66 (1975) that an implied private right of action under federal law will lie only for members of the class which the law is especially designed to benefit, and that actions traditionally relegated to state law will not be impliedly subsumed under federal law. This tends to undermine the *Bankers Life* holding that a creditor has an implied right of action under §10(b), a law designed to protect purchasers and sellers of securities. Similarly inconsistent with *Cort* is the *Bankers Life* disregard of the availability of state law remedies in its consideration of the existence of a 10b-5 cause of action.

115. See *Chris-Craft Indus., Inc. v. Piper Aircraft Corp.*, 480 F.2d 341 (2d Cir.), *cert. denied*, 414 U.S. 910 (1973); *Green v. Santa Fe Indus., Inc.*, 533 F.2d 1283 (2d Cir. 1976), *rev'd*, 430 U.S. 462 (1977).

116. 480 F.2d 341 (2d Cir.), *cert. denied*, 414 U.S. 910 (1973).

117. *Id.* at 360. While the court's reasoning is unclear on this point, its holding that § 14(e) establishes a federal cause of action for interference with prospective economic advantage seems to flow from a perception that the Williams Act supersedes all state corporate regulation in tender offer situations. See *id.*

offer.¹¹⁸

The Second Circuit followed this decision with an even more egregious intrusion into the domain of the states. In *Green v. Santa Fe Indus., Inc.*,¹¹⁹ the court held that neither misrepresentation nor nondisclosure were essential to a 10b-5 claim, and that 10b-5 established a federal cause of action for breach of fiduciary duty.¹²⁰ The *Green* court further held that compliance with applicable state regulations would not satisfy 10b-5, stating that a transaction challenged under 10b-5 must comport with federal standards of fairness.¹²¹

In *Green*, a parent corporation which held 95% of the stock of a subsidiary had merged with the subsidiary in a statutory merger which enabled the parent to force the minority shareholders of the subsidiary to sell their stock to the parent for cash.¹²² The state law merger procedure required that the parent pay minority shareholders the judicially-appraised value of their shares in the event the minority felt the price offered by the parent was inadequate.¹²³ Despite compliance with this state procedure and full disclosure of the terms of the merger to the minority, the Second Circuit found a 10b-5 violation.¹²⁴ The court held that 10b-5 created a federal fiduciary standard which requires that all corporate transactions serve some "justifiable business purpose" beyond the enrichment of the majority shareholders.¹²⁵ Finding that the merger in *Green* served only to enhance the value of the parent company's holdings through elimination of the minority shareholders, the court held that the parent had violated this standard and was therefore liable under 10b-5.¹²⁶

After *Green*, it appeared that a federal regime of corporate governance had arisen in the form of Section 10(b) and Rule 10(b)-5.¹²⁷

118. *Id.* at 360-61.

119. 533 F.2d 1283 (2d Cir. 1976), *rev'd*, 430 U.S. 462 (1977).

120. *Id.* at 1291.

121. *Id.*

122. *Id.* at 1288. Section 253 of the Delaware Corporation Law permits a parent corporation which owns at least 90% of a subsidiary to merge with the subsidiary upon approval by the board of directors and shareholders of the parent. The consent of the minority shareholders is not required, and they may be forced to sell their interest in the subsidiary to the parent. DEL. CODE ANN. tit. 8 § 253 (1983).

123. See DEL. CODE ANN. Tit. 8 § 253 (1983).

124. 533 F.2d at 1291.

125. *Id.* The gist of the reasoning for this holding was the court's characterization of a breach of fiduciary duty as a "fraud" within the meaning of the Rule 10b-5 prohibition of the use in securities transactions of "any device, scheme or artifice to defraud." 17 C.F.R. 240.10b-5(1) (1984).

126. 533 F.2d at 1291.

127. Many commentators had noted prior to *Green* that substantive federal standards of corporate management were emerging under § 10(b). See Fleischer, *Federal Corporation Law: An*

Although the Supreme Court had taken some action to tighten up the standing requirements under these provisions,¹²⁸ the lower courts had enlarged the substantive scope of the statute to include conduct wholly unrelated to the "full disclosure" aims of the securities laws.¹²⁹ Thus, the stage was set for the Supreme Court's review of the Second Circuit's decision in *Green*.

In *Santa Fe Indus., Inc. v. Green*,¹³⁰ the Supreme Court called a halt to the expansion of securities laws into areas of corporate activity traditionally regulated by the states.¹³¹ Emphatically rejecting the Second Circuit's contention that Section 10(b) creates federal fiduciary standards, the Court held that regulation of substantive corporate conduct is the exclusive province of state law.¹³² The Court held that where a shareholder alleges that a corporate transaction is unfair, the claim is of a breach of fiduciary duty, and must be adjudicated under state law.¹³³

The *Santa Fe* court emphasized that the federal securities laws are designed only to ensure full and accurate disclosure of information rel-

Assessment, 78 HARV. L. REV. 1146 (1965); Jacobs, *The Role of Securities Exchange Act Rule 10(b)-5 in the Regulation of Corporate Management*, 59 CORNELL L. REV. 27 (1973); Jennings, *Federalization of Corporation Law: Part Way or All the Way*, 31 BUS. LAW. 991 (1976). Perhaps the most significant article of all on the subject of the efficacy of federal regulation of corporate management is Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663 (1974). Cary argued that the states had grown lax in the protection of shareholders, and that a federal corporate law was necessary to shield investors from abuses of power by corporate insiders.

128. In *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, *reh'g denied*, 423 U.S. 884 (1975), the Supreme Court held that only an actual purchaser or seller of securities had standing to sue under § 10(b). A year later, in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, *reh'g denied*, 425 U.S. 986 (1976), the Court held that a § 10(b) plaintiff must allege "scienter" on the part of the defendant in order to state a claim. The Court defined "scienter" in the context of § 10(b) as the intent to deceive, manipulate or defraud. *Id.* at 193.

129. The Williams Act was not immune to the fever of expansionism sweeping the federal courts. In *Applied Digital Data Systems, Inc. v. Milgo Electronic Corp.*, 425 F. Supp. 1145 (S.D.N.Y. 1977), decided on the eve of the Supreme Court decision in *Santa Fe*, § 14(e) was held to create a federal cause of action for breaches of fiduciary duty relating to a tender offer. *Id.* at 1158. The court held that, where target directors allegedly breached their fiduciary duties by depriving shareholders of the opportunity to tender their shares to a tender offeror whose bid for control was thwarted by the target directors' defensive tactics, § 14(e) entitled the tender offeror to an injunction barring the target directors from culminating a defensive sale of stock. *Id.* at 1161-62.

130. 430 U.S. 462 (1977).

131. *Id.* at 478-79. The Court held that federal fiduciary standards "would overlap and quite possibly interfere with state corporate law." *Id.* at 479.

132. *Id.* at 479. The Court stated, "Absent a clear indication of congressional intent, we are reluctant to federalize the substantial portion of the law of corporations that deals with transactions in securities, particularly where established state policies of corporate regulation would be overridden." *Id.*

133. *Id.* at 477.

evant to securities transactions.¹³⁴ Absent misrepresentation or nondisclosure, an unfair transaction does not violate federal law.¹³⁵ Because neither misrepresentation nor nondisclosure was alleged in *Santa Fe*, the Court held that the plaintiff had failed to state a claim under Section 10(b).¹³⁶

Santa Fe effectively reestablished the boundary between state and federal corporate regulation, and refocused the securities laws on the disclosure goals for which they were designed.¹³⁷ Since *Santa Fe*, the lower courts have confined liability under the securities laws to conduct involving misrepresentation or nondisclosure.¹³⁸ For the most part, the courts have heeded the Supreme Court's corollary directive that complaints relating to the substantive fairness of fully disclosed transactions are to be resolved under state law.¹³⁹

134. *Id.* at 478. "The 'fundamental purpose' of the [Securities Exchange] Act [is] implementing a 'philosophy of full disclosure'; once full and fair disclosure has occurred, the fairness of the terms of the transaction is at most a tangential concern of the statute." *Id.*

135. *Id.* at 476.

136. *Id.* at 476-77.

137. See Hazen, *Corporate Mismanagement and the Federal Securities Act's Antifraud Provisions: A Familiar Path with Some New Detours*, 20 BOSTON COLL. L. REV. 819 (1979); Block & Schwarzfeld, *Corporate Mismanagement and Breach of Fiduciary Duty After Santa Fe v. Green*, 2 CORP. L. REV. 91 (1979); Note, *Tender Offer Defensive Tactics—Federal Regulation of Management's Prerogative*, 10 FORDHAM URB. L.J. 633 (1982).

138. After *Santa Fe*, federal courts began to dismiss § 10(b) and 10b-5 claims which failed to allege deception. See, *Cole v. Schenley Indus., Inc.*, 563 F.2d 35 (2d Cir. 1977); *Nash v. Farmer's New World Life Ins. Co.*, 570 F.2d 558 (6th Cir. 1978), cert. denied, 439 U.S. 822 (1978); *Reid v. Hughes*, 578 F.2d 634 (5th Cir. 1978).

139. See *Golub v. PPD Corp.*, 576 F.2d 759 (8th Cir. 1978); *Panter v. Marshall Field & Co.*, 646 F.2d 271 (7th Cir. 1981), cert. denied, 454 U.S. 1092 (1981); *Whittaker Corp. v. Edgar*, 535 F. Supp. 933 (N.D. Ill. 1982). It is interesting to note that Congress has routinely rejected proposed legislation which would have created federal standards of corporate law. See, S. 2567, 96th Cong., 2d Sess.; 126 Cong. Rec. S. 3754-57 (Apr. 16, 1980) ("Protection of Shareholder's Rights Act of 1980"); H.R. 7010, 96th Cong., 2d Sess. ("The Corporate Democracy Act of 1980") (introduced at 126 Cong. Rec. H2490 (Apr. 2, 1980)). The SEC has been similarly reluctant to regulate the substantive fairness of corporate transactions since *Santa Fe*. The Commission's rule on "going private transactions" provides a case-in-point. See 17 C.F.R. § 240.13e (1983). Prior to *Santa Fe*, the Commission proposed a rule which would regulate the substantive fairness of transactions in which a public corporation buys out its public shareholders, or "goes private." See Securities Act Release No. 5567, 6 SEC Docket 250, 265 (1975); Securities Act Release No. 5884, 13 SEC Docket 839, 851 (1977). In the final version of the rule, adopted subsequent to *Santa Fe*, the Commission confined itself to establishing disclosure requirements for such transactions, and deferred to the states on matters of substantive fairness. Securities Act Release No. 6100, 17 SEC Docket 1449, 1450-51 (1979). For further discussion of the regulation of "going private" transactions, see Silver, *Fair Dealing Comes of Age in the Regulation of Going Private Transactions*, 9 J. CORP. L. 385 (1984).

Recently, legislation was introduced which would regulate the substantive conduct of target directors responding to a tender offer. H.R. Rep. 98-1028 to accompany H.R. 5693 (Report of the House Committee on Energy and Commerce on The Tender Offer Reform Act, Sept. 7, 1984). This proposed amendment to the Williams Act would have subjected certain target defensive measures to approval by a majority of the shareholders of the target company. Specifically, the bill would have required shareholder approval of acquisitions or issuances of stock by a target board during the pendency of a tender offer. The comments accompanying the bill as reported by

Santa Fe prompted the lower courts to reassess the nature of the relationship between the securities laws and state corporate law.¹⁴⁰ Some courts concluded that the disclosure requirements of federal law should complement state regulation of corporate management.¹⁴¹ The Second Circuit applied this theory in *Goldberg v. Meridor*,¹⁴² holding that a 10b-5 action would lie for nondisclosure of facts which would entitle shareholders to enjoin a corporate transaction under state law.¹⁴³ Other federal courts have followed this approach to the federal-state dichotomy, as it seems consistent with the *Santa Fe* instruction that federal law seeks only to provide full disclosure of material facts relating to securities transactions.¹⁴⁴

The lower federal courts quickly comprehended the significance of *Santa Fe* in the context of Williams Act litigation.¹⁴⁵ In *Altman v.*

the House Committee on Energy and Commerce indicated that the proposed restrictions were a response to a perceived failure of the courts to adequately protect target shareholders against defensive tactics which are harmful to the target corporation. If this legislation had passed, it would have represented a significant departure from the traditional doctrine that the relationships between shareholders and directors are regulated by state law.

However, the 98th Congress adjourned without acting on the bill, and legislators have indicated that it will not be reintroduced. Instead, there will be a comprehensive review of all federal regulations relating to corporate takeovers. This review will involve hearings lasting through the fall of this year, making the enactment of revisions of the federal takeover laws unlikely to come to pass before 1986. 17 Sec. Reg. L. Rep. 47 (1/11/85).

140. See, *Wright v. Heizer Corp.*, 560 F.2d 236 (7th Cir. 1977), *cert. denied*, 434 U.S. 1069 (1978); *Goldberg v. Meridor*, 567 F.2d 209 (2d Cir. 1977), *cert. denied*, 434 U.S. 1066 (1978).

141. See, *Wright v. Heizer Corp.*, 560 F.2d at 250.

142. 567 F.2d 209 (2d Cir. 1977), *cert. denied*, 434 U.S. 1066 (1978).

143. *Id.* at 219-20.

144. See, *Kidwell v. Meikle*, 597 F.2d 1273, 1292 (9th Cir. 1979); *Alabama Farm Bureau Mut. Cas. Co., Inc. v. American Fidelity Life Ins. Co.*, 606 F.2d 602, 614 (5th Cir. 1979), *cert. denied*, 449 U.S. 820 (1980); *Healey v. Catalyst Recovery of Pennsylvania*, 616 F.2d 641, 646 (3d Cir. 1980); *but see Madison Consultants v. Federal Deposit Insurance Corp.*, 710 F.2d 57, 65 (2d Cir. 1983) (explains that mere existence of state law remedy for the challenged conduct is insufficient; plaintiff must show he would have succeeded in preventing his loss in the state action); *Mayer v. Oil Field Systems Corp.*, 721 F.2d 59, 67 (2d Cir. 1983). As Hazen points out, this approach enhances shareholders protection against management abuses by requiring disclosure of facts which would alert shareholders to a violation of their rights. Hazen, *Corporate Mismanagement and the Federal Securities Act's Antifraud Provisions: A Familiar Path with Some New Detours*, 20 BOSTON COLL. L. REV. 819, 837 (1979). Hazen further explains that the use of federal law to compel disclosure of facts which amount to violations of state law strengthens rather than infringes state corporate regulation. *Id.* at 837. Applying this principle to tender offer regulation, Hazen argues that the proper role of § 14(e) of the Williams Act is to require disclosure of violations of fiduciary duties and other state laws during a tender offer. *Id.* at 855. See also Note, *Tender Offer Defensive Tactics—Federal Regulation of Management's Prerogative*, 10 FORDHAM URB. L.J. 633, 652 (1982).

145. See *Golub v. PPD Corp.*, 576 F.2d 759 (8th Cir. 1978); *Panter v. Marshall Field & Co.*, 646 F.2d 271 (7th Cir.), *cert. denied*, 454 U.S. 1092 (1981); *Billard v. Rockwell International Corp.*, 683 F.2d 51 (2d Cir. 1982); *Altman v. Knight*, 431 F. Supp. 309 (S.D.N.Y. 1977); *Martin-Marietta Corp. v. Bendix Corp.*, 549 F. Supp. 623 (D. Md. 1982); *Whittaker Corp. v. Edgar*, 535 F. Supp. 933 (N.D. Ill. 1982). Citing *Santa Fe*, the Second Circuit in *Billard* held that "the fairness of the offering price is not a valid basis for an action under Sections 10(b) and 14(e) . . ." 683 F.2d at 56.

Knight,¹⁴⁶ the Southern District of New York held that, after *Santa Fe*, the Williams Act requires no more than full disclosure by the parties to a tender offer.¹⁴⁷ The court found that the substantive fairness of the actions of the parties is beyond the scope of the Act.¹⁴⁸ Therefore, allegations that fully disclosed target defensive tactics were unfair to target shareholders were cognizable only under state law.¹⁴⁹

The Supreme Court, in *Edgar v. MITE Corp.*,¹⁵⁰ implicitly affirmed this application of *Santa Fe* to the Williams Act, overturning an Illinois tender offer law.¹⁵¹ The infirmity of the Illinois law was its provision for state scrutiny of the fairness of the terms of a tender offer.¹⁵² Holding that the Williams Act is solely a disclosure statute, unconcerned with the fairness of tender offers, the Court held that the Illinois policy of "investor protection at the expense of investor autonomy" was inconsistent with the purposes of the Williams Act.¹⁵³

As the foregoing discussion indicates, the Sixth Circuit's invocation of Section 14(e) in *Mobil* as a mandate for federal redress of the perceived unfairness of tender offer defensive tactics contravenes basic precepts of securities law. *Santa Fe* commands that federal courts defer to state law on issues of substantive fairness in corporate transactions.¹⁵⁴ Similarly, the Sixth Circuit's assertion that a Section 14(e) breach can occur without misrepresentation or nondisclosure flies in the face of the Supreme Court's holding that the securities laws are satisfied upon full and fair disclosure of information relevant to an investor's decision on a securities transaction.¹⁵⁵

Although the *Mobil* court acknowledged that *Santa Fe* placed claims of unfairness and breach of fiduciary duty beyond the scope of the securities laws,¹⁵⁶ it disposed of the issue with a conclusory statement that the plaintiff had alleged more than a fiduciary breach.¹⁵⁷ This bald assertion failed to address the salient inquiry under *Santa Fe*. *Santa Fe* points out that complaints of unfairness in a corporate trans-

146. 431 F. Supp. 309 (S.D.N.Y. 1977).

147. *Id.* at 314.

148. *Id.*

149. *Id.*

150. 457 U.S. 624 (1982).

151. *Id.* at 639.

152. *Id.*

153. *Id.* at 640.

154. 430 U.S. at 477.

155. *Id.* at 477-78.

156. 669 F.2d at 374.

157. *Id.*

action are actually claims of breach of fiduciary duties.¹⁵⁸ Therefore, a conclusion that a complaint alleges more than a fiduciary breach depends on an initial finding that the complaint is based on something more than the asserted unfairness of the transaction.¹⁵⁹ *Santa Fe* establishes that this "something more" is deception, i.e., misrepresentation or nondisclosure.¹⁶⁰

Although the Sixth Circuit court never divulged precisely what the *Mobil* complaint did allege, the facts reveal that there was no misrepresentation or nondisclosure regarding the challenged "lock-up options."¹⁶¹ Indeed, the sole basis for the court's dissatisfaction with the options was its perception that they were unfair to the Marathon shareholders.¹⁶² Clearly, the deception essential to a federal cause of action was absent in *Mobil*.

The desire to avoid further exposure to the principles of *Santa Fe* would seem to explain the Sixth Circuit's decision to heap all the liability for the Section 14(e) violation on U.S. Steel.¹⁶³ In dealing with the argument that *Santa Fe* bars federal adjudication of fiduciary duty claims, the court stated that more than a fiduciary breach had been alleged, and accepted the lower court's determination that the Marathon directors had not breached their fiduciary duties.¹⁶⁴ The court then examined the impact of the options on Marathon shareholders, and found a violation of Section 14(e).¹⁶⁵ The court apparently felt that its exoneration of the Marathon directors on the fiduciary duty count, precluded it from holding them liable for the Section 14(e) violation.¹⁶⁶ This left the court no choice but to pin the violation on U.S. Steel, whom the court excoriated for presenting the Marathon directors with a "take-it-or-leave-it" proposition which conditioned the U.S. Steel tender offer on the grant of the options.¹⁶⁷ The court held that the Section 14(e) violation lay in U.S. steel's "demand" for the options, and

158. See 430 U.S. at 477.

159. See *id.* at 476-77.

160. *Id.*

161. See 669 F.2d at 376.

162. *Id.* at 377.

163. *Id.*

164. *Id.*

165. *Id.*

166. The court indicated some displeasure with U.S. Steel's presentation of the options as part of a "take-it-or-leave-it" proposal to the Marathon directors during the negotiations which led to U.S. Steel's tender offer. *Id.* Nevertheless, the facts do not support a conclusion that U.S. Steel occupied a position of dominance in relation to the Marathon directors such as would have enabled it to coerce Marathon into granting the options.

167. *Id.*

not in the grant of the options by Marathon's directors.¹⁶⁸ This confusing resolution ignores the logical inconsistency of holding the beneficiary of an illegal act fully liable, while exculpating the party who voluntarily performed the act.

The Second and Third Circuits have recognized that *Mobil* disregards the fundamental principle that the securities laws are concerned not with the substantive fairness of corporate transactions, but with full disclosure of all facts relevant to those transactions.¹⁶⁹ *Buffalo Forge* and *Schreiber* correctly interpret *Santa Fe* as a bar to federal judicial scrutiny of the fairness of tender offer strategies.¹⁷⁰ The refusal of these courts to invalidate fully disclosed transactions comports with basic disclosure goal of the securities laws, and preserves the balance between state and federal law in the field of corporate regulation.

Under the *Buffalo Forge-Schreiber* analysis, there is room for a holding that concealment of facts constituting a breach of a state law fiduciary duty would violate Section 14(e). Such a holding would comport with the complementary relationship between federal securities regulation and state corporate law.¹⁷¹ Furthermore, requiring that directors disclose actions which may constitute violations of state law would maximize shareholder protection in tender offer situations. Once advised that directors have violated state law, shareholders would be able to seek redress of the violation in state court.

B. *The Purpose of the Williams Act*

The Williams Act was Congress' response to the dramatic increase in tender offer activity in the mid-1960's.¹⁷² The Act contains several specific disclosure and timing requirements¹⁷³ and, in 14(e), a broad antifraud provision.¹⁷⁴ Section 14(e) prohibits "fraudulent, deceptive, or manipulative" conduct by anyone in connection with a tender of-

168. *Id.*

169. See *Buffalo Forge v. Ogden Corp.*, 717 F.2d 757 (2d Cir. 1983), *cert. denied*, 104 S. Ct. 550 (1984); *Data Probe Acquisition Corp. v. Datatab, Inc.*, 722 F.2d 1 (2d Cir. 1983), *cert. denied*, 104 S. Ct. 1326 (1984); *Schreiber v. Burlington Northern, Inc.*, 731 F.2d 163 (3d Cir. 1984), *cert. granted*, 53 U.S.L.W. 3204 (1984).

170. 717 F.2d at 760; 731 F.2d at 166.

171. See notes 139-143 and accompanying text.

172. H.R. Rep. No. 1711, 90th Cong., 2nd Sess., *reprinted in* 1967 U.S. CODE CONG. & AD. NEWS 2811. The House Report of the bill which became the Williams Act indicates that the Act was a response to "[t]he increased use of cash tender offers to acquire control of corporations, [which] is evidenced by the fact that in 1966 there were over 100 such offers involving companies listed on the national securities exchanges, as compared with eight in 1960." *Id.* at 2812.

173. 15 U.S.C. §§ 781(i), 78m(d), (e), 78n(d), (f) (1982).

174. 15 U.S.C. § 78n(e) (1982).

fer.¹⁷⁵ Unfortunately, the Act does not define these terms, and the Securities Exchange Commission has yet to exercise the power given to it by the 1970 amendment to Section 14(e)¹⁷⁶ to define such acts as are "manipulative" under the Act. An examination of the purpose of the Williams Act, as expressed in the legislative history, provides a context in which to determine the proper scope of Section 14(e).

The record of congressional debate on the Williams Act shows that the impetus for the legislation was Congress' concern¹⁷⁷ that tender offers were not subject to the disclosure requirements of the Securities Act of 1934.¹⁷⁸ The author of the bill, Senator Thomas Harrison Williams, declared that the "essential problem" with the emergence of the tender offer as the primary corporate takeover mechanism was the ability of offerors "to operate in almost complete secrecy concerning their intentions, their commitments and even their identities."¹⁷⁹ To underscore the necessity of disclosure in tender offers, the cosponsor of the bill, Senator Thomas Kuchel, recounted for his colleagues the near-takeover of Columbia Motion Pictures through a tender offer which concealed the identity of the persons behind the offer.¹⁸⁰ Kuchel warned that the absence of disclosure requirements for tender offers allowed "takeover pirates" to acquire corporations without disclosing so much as their identities, let alone their plans to loot the companies once in control.¹⁸¹

Further legislative comment indicates that Congress' sole intention in passing the bill was to eliminate this blind spot in the disclosure

175. *Id.*

176. Pub. L. 91-567 §§ 3-5; 84 Stat. 1497 (Dec. 22, 1970).

177. H.R. Rep. No. 1711, 90th Cong., 2nd Sess., reprinted in 1967 U.S. CODE CONG. & AD. NEWS 2811. The report points out that there are significant advantages in seeking control of a company by the cash tender offer:

One such advantage is that by using a cash tender offer the person seeking control can operate in almost complete secrecy. At present, the law does not even require that he disclose his identity, the source of his funds, who his associates are, or what he intends to do if he gains control of the corporation. As a practical matter, unless incumbent management explains its position publicly, the investor is severely limited in obtaining all the facts on which to base a decision whether to accept or reject a tender offer.

Id. at 2812.

178. 48 Stat. 891 (1934) (codified as amended in scattered sections of 15 U.S.C. §§ 77, 78 (1982)).

179. 113 CONG. REC. 854 (daily ed. July 18, 1967).

180. *Id.* at 857. Senator Kuchel cautioned that:

Today there are those individuals in our financial community who seek to reduce our proudest businesses into nothing but corporate shells. They seize control of the corporation with unknown sources, sell or trade away the best assets, and later split up the remains among themselves. The tragedy of such collusion is that the corporation can be financially raped without management or shareholders having any knowledge of the acquisitions. *Id.*

181. *Id.* at 855.

requirements of the securities laws.¹⁸² Introducing the bill, Williams stated, "this legislation will close a significant gap in investor protection under the federal securities laws by requiring the disclosure of pertinent information to stockholders when persons seek to obtain control of a corporation by a cash tender offer."¹⁸³ Williams explained that the bill was designed to subject tender offers to the same disclosure requirements the existing laws imposed on other stock transactions.¹⁸⁴

The narrowness of the intended purpose of the Act is evident in Williams' statements upon the report of the bill by the Senate Banking and Currency Committee.¹⁸⁵ He declared that the bill was "designed solely to require full and fair disclosure for the benefit of investors."¹⁸⁶ Williams went on to detail the disclosure requirements which ultimately became law under the Act.¹⁸⁷ Nowhere in the comments of Williams or others is there evidence of an intent that the Act achieve any purpose beyond ensuring full disclosure to stockholders of all information relevant to their decision of whether to accept or reject a tender offer.

Although most of the legislative commentary on the bill is of a general nature, the House Report articulates the specific aim of Section 14(e).¹⁸⁸ The report says that Section 14(e) affirms that "persons engaged in making or opposing tender offers or otherwise seeking to influence the decision of investors or the outcome of the tender offer are under an obligation to make a full disclosure of material information to those with whom they deal."¹⁸⁹ This comment evinces an intention to restrict Section 14(e) to a field of operation bounded by the limited purpose of the Act as a whole. Specifically, the comment indicates that

182. *See id.* at 854-55. Senator Williams stated that "The purpose of this bill is to require full and fair disclosure for the benefit of stockholders while at the same time providing the offeror and management equal opportunity to fairly present their case." *Id.*

183. *Id.* at 854.

184. *Id.* at 855.

185. *See generally id.* at 24,664 (August 30, 1967).

186. *Id.*

187. *Id.* Williams said that the bill would require tender offerors to disclose:

The size of the holdings of the person or group involved.

The source of the funds to be used to acquire the shares except where the funds are acquired from a bank in the ordinary course of business.

Any financing arrangements made for these funds and how these arrangements will be liquidated.

The plans of the offeror—if he wins control of the company—whether to liquidate it, sell its assets, merge it with another company, or to make major changes in its business or corporate structure.

Id.

188. H.R. REP. NO. 1711, 90th Cong., 2nd Sess., *reprinted in* 1967 U.S. CODE CONG. & AD. NEWS 2811, 2821.

189. *Id.*

the purpose of Section 14(e) is to require disclosure by those participants in tender offer battles whose activities might not be reached by the other provisions of the Act. Neither the House Report, nor any other legislative comments reveal any intent that Section 14(e) be used to effect any policy beyond the general disclosure goals of the Act as a whole.

The passages cited above are but a sampling of the congressional comment on the Williams Act. The rest of the proceedings demonstrate virtual unanimity of understanding by the legislators that the sole purpose of the Act is to require full disclosure in connection with tender offers. The viewpoint that the Williams Act is more than a disclosure statute and that Section 14(e) is a tool for judicial regulation of tender offer competition finds no support in the legislative history of the Act.

The legislative history overwhelmingly supports the *Buffalo Forge* and *Schreiber* interpretations of the purpose of the Act. The clearly expressed intention of the framers of the Act was to require full disclosure in tender offer contests, and nothing more. Nothing in the legislative history supports the *Mobil* assertion that the Act is designed to regulate competition among tender offerors and establish standards of substantive fairness for transactions connected with tender offers.

Although the Supreme Court's first direct consideration of the necessity of deception to a Section 14(e) claim will come in *Schreiber*,¹⁹⁰ the Court has addressed the general purpose of the Williams Act in a number of previous decisions.¹⁹¹ In these cases, the Court has consistently maintained that the Act is solely a disclosure statute.¹⁹² In *Piper v. Chris-Craft Industries*,¹⁹³ for example, the Court construed the Williams Act as "a disclosure mechanism aimed especially at protecting shareholders of target corporations."¹⁹⁴ The recent decision in *Edgar v. MITE Corp.*,¹⁹⁵ reaffirms the Court's stance that the Act is designed

190. 731 F.2d 163 (3d Cir. 1984), *cert. granted*, 53 U.S.L.W. 3204 (Oct. 2, 1984), *argued* January 9, 1985.

191. See *Rondeau v. Mosinee Paper Corp.*, 422 U.S. 49 (1975); *Piper v. Chris-Craft Indus. Inc.*, 430 U.S. 1, *reh'g denied*, 430 U.S. 976 (1977); *Edgar v. MITE Corp.*, 457 U.S. 624 (1982).

192. In *Rondeau*, the Court summarized the purpose of the Act, holding:

The purpose of the Williams Act is to ensure that public shareholders who are confronted with a cash tender offer for their stock will not be required to respond without adequate information regarding the qualifications and intentions of the offering party.

422 U.S. at 58.

193. 430 U.S. 1 (1977).

194. *Id.* at 39.

195. 457 U.S. 624 (1982).

only to require full disclosure by tender offer participants.¹⁹⁶ With the exception of the Sixth Circuit, the lower courts have been uniformly faithful to the Supreme Court's narrow construction of the Act.¹⁹⁷

As the previous section explained, the *Santa Fe* holding that the securities laws are unconcerned with the substantive fairness of corporate transactions is fully applicable to the Williams Act.¹⁹⁸ Nevertheless, *Mobil* enjoined lock-up options under Section 14(e) on the basis of the court's dissatisfaction with the fairness of the options to Marathon shareholders.¹⁹⁹ Such a result is irreconcilable with the rule of *Santa Fe* reserving fairness issues to state law.

The *Mobil* claim that the Williams Act is intended to assure each competing tender offeror equal footing in the struggle for control of the target is similarly inconsistent with previous interpretations of the Act.²⁰⁰ As the *Buffalo Forge* court pointed out,²⁰¹ the Supreme Court in *Piper v. Chris-Craft Industries*²⁰² held that "tender offerors were not the intended beneficiaries of the bill . . ." ²⁰³ The *Piper* Court denied a defeated tender offeror standing to seek damages under Section 14(e) for harm allegedly suffered as a result of the tactics used by the victor during the battle for the target.²⁰⁴

Another discussion of the applicability of Section 14(e) to target actions which confer an advantage on a "friendly" tender offeror is found in *Billard v. Rockwell International Corp.*²⁰⁵ There, a shareholder mounted a Section 14(e) challenge to agreements which virtu-

196. *Id.* at 633.

197. See *Swanson v. Wabash*, 577 F. Supp. 1308, 1315 (N.D. Ill. 1983) (express rejection of *Mobil*); *Data Probe Acquisition Corp. v. Datatab, Inc.*, 722 F.2d 1, 5 (2d Cir. 1983), *cert. denied*, 104 S. Ct. 1326 (1984) (Second Circuit following its decision in *Buffalo Forge*); *Atchley v. Qonaar Corp.*, 704 F.2d 355, 359 (7th Cir. 1983); *Martin-Marietta Corp. v. Bendix Corp.*, 549 F. Supp. 623, 628 (D. Md. 1982); *Hundahl v. United Benefit Life Ins. Co.*, 465 F. Supp. 1349, 1359 (N.D. Tex. 1979); *Berman v. Gerber Prods. Co.*, 454 F. Supp. 1310, 1319-21 (W.D. Mich. 1978).

198. See *supra* notes 144-52 and accompanying text.

199. See 669 F.2d at 376-77.

200. See *Piper v. Chris-Craft Indus., Inc.*, 430 U.S. 1, *reh'g denied*, 430 U.S. 976 (1977); *Panther v. Marshall Field & Co.*, 646 F.2d 271 (7th Cir. 1981), *cert. denied*, 454 U.S. 1092 (1981); *Billard v. Rockwell International Corp.*, 683 F.2d 51 (2d Cir. 1982).

201. 717 F.2d at 760.

202. 430 U.S. 1, *reh'g denied*, 430 U.S. 976 (1977).

203. *Id.* at 28. The Court held that the Williams Act was enacted solely for the protection of shareholders of target corporations. From this the Court concluded that a defeated tender offeror did not have standing under § 14(e) to sue a victorious adversary. *Id.* at 35-36. Although beyond the scope of this article, it is interesting to note the *Mobil* court's rationale for granting standing to *Mobil*. See *Mobil*, 669 F.2d at 370-73. The Second Circuit in *Buffalo Forge* avoided the standing question by the unusual procedure of first disposing of the merits of the § 14(e) claim, and then holding that the determination on the merits rendered consideration of the standing issue unnecessary. See 717 F.2d at 760-61.

204. *Piper*, 430 U.S. at 28.

205. 683 F.2d 51 (2d Cir. 1982).

ally assured the success of a tender offeror favored by target management.²⁰⁶ The Second Circuit held that allegations that the agreements deterred possible competing tender offers failed to state an actionable claim under Section 14(e).²⁰⁷ The Seventh Circuit in *Panter v. Marshall Field & Co.*,²⁰⁸ rejected a similar challenge to actions of target directors.²⁰⁹ The *Panter* court refused to invalidate target defensive tactics, holding that the tendency of the tactics to make a particular offeror's bid for control more difficult did not constitute a Section 14(e) violation.²¹⁰ These cases demonstrate that the *Mobil* court's concern for the impact of the U.S. Steel options on other tender offerors' chances of success²¹¹ was not a proper consideration under the Williams Act.

The import of the foregoing decisions of the Supreme Court and lower federal courts addressing the purpose of the Williams Act was apparently lost on the *Mobil* court. *Mobil* acknowledged only *Santa Fe* in its consideration of the defendants' argument that the Act requires no more than full disclosure.²¹² The court dismissed this defense with the perfunctory retort that "the defendants read too much into . . ." the *Santa Fe* holding that the securities laws are concerned solely with "implementing a philosophy of full disclosure."²¹³

More disturbing than *Mobil's* cursory treatment of *Santa Fe* is its complete disregard of the Supreme Court's explicit articulations of the purpose of the Williams Act in *Piper* and in *Rondeau v. Mosinee Paper Corp.*²¹⁴ These two decisions unequivocally deny the Williams Act any function beyond the monitoring of disclosure in tender offer contests.²¹⁵ Had the Sixth Circuit given these cases due consideration, it could not ingenuously have concluded that fully disclosed lock-up options violate the Williams Act.

206. *Id.* at 55. The challenged agreements gave a tender offeror which already held a majority of the target's stock control of the target board of directors. *Id.*

207. *Id.*

208. 646 F.2d 271 (7th Cir.), *cert. denied*, 454 U.S. 1092 (1981).

209. *Id.* at 288. The Seventh Circuit upheld the validity under § 14(e) of acquisitions and antitrust litigation designed to thwart a tender offeror's bid for control. *Id.*

210. *Id.*

211. *See* 669 F.2d at 377.

212. *Id.* at 376.

213. *Id.*

214. *See* *Piper v. Chris-Craft Indus., Inc.*, 430 U.S. 1, 31, *reh'g denied*, 430 U.S. 976 (1977); *Rondeau v. Mosinee Paper Corp.*, 422 U.S. 49, 58 (1975).

215. In *Piper*, the Supreme Court held that the Williams Act "was designed solely to get needed information to the investor." 430 U.S. at 31. *Rondeau* holds that the purpose of the Act is to assure shareholders "adequate information regarding the qualifications and intentions of the offering party." 422 U.S. at 58.

The *Buffalo Forge* court, on the other hand, understood that *Piper* and *Rondeau* were controlling authority on the purpose of the Williams Act.²¹⁶ The Second Circuit's refusal to use Section 14(e) to vitiate a fully disclosed lock-up agreement represented a return to the previously undisputed construction of the Williams Act as a pure disclosure statute unconcerned with the substantive fairness of tender offers.²¹⁷ The *Schreiber* court's refusal to entertain under Section 14(e) a claim arising out of fully disclosed conduct²¹⁸ is similarly consistent with the purpose of the Act. Both courts wisely declined to follow *Mobil*,²¹⁹ which the Second Circuit succinctly termed an "unwarranted extension of the Williams Act."²²⁰

C. The Meaning of "Manipulation" Under Section 14(e)

The genesis of the dispute between the Courts of Appeals on the interpretation of Section 14(e) is in the failure of Congress to provide a statutory definition of the term "manipulative acts." Neither the Williams Act nor the Securities Exchange Act of 1934 include such a definition, though both proscribe such activities.²²¹ It has thus been left to the courts to identify the elements of the prohibited "manipulation."

The Supreme Court has recognized that the term "manipulative" is "virtually a term of art when used in connection with securities markets."²²² The Court's most thorough analysis of the meaning of "manipulation" came in *Santa Fe Industries v. Green*,²²³ where the meaning of the term as used in Section 10(b) of the 1934 Act was at issue.²²⁴ Reiterating that "manipulation" has a special meaning in the securities context,²²⁵ the Court stated that the term refers generally to practices "such as wash sales, matched orders, or rigged prices, *that are intended to mislead investors* by artificially affecting market activity."²²⁶ The Court held that there could be no violation of Section 10(b) "without any deception, misrepresentation or nondisclosure . . ."²²⁷

216. 717 F.2d at 760.

217. *Id.*

218. 731 F.2d at 166.

219. 717 F.2d at 760, 731 F.2d at 166.

220. 717 F.2d at 760.

221. See Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1982).

222. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199, *reh'g denied*, 425 U.S. 986 (1976) (construing "manipulation" as used in § 10(b) of the 1934 Act).

223. 430 U.S. 462 (1977).

224. *Id.*

225. *Id.* at 476.

226. *Id.* (emphasis added).

227. *Id.*

Although the Supreme Court has yet to define "manipulation" under Section 14(e), the lower courts have held that the *Santa Fe* definition of Section 10(b) "manipulation" is applicable to Section 14(e).²²⁸ In *Panter v. Marshall Field & Co.*,²²⁹ the Seventh Circuit held that Section 10(b) and Section 14(e) are coextensive antifraud provisions, and are therefore to be considered *in pari materia*.²³⁰ Proceeding on this basis, the court determined that the *Santa Fe* requirement of misrepresentation or nondisclosure is applicable to Section 14(e).²³¹

The *Santa Fe* decision alone is solid support for the *Buffalo Forge* holding that "[a]n essential ingredient of a section 14(e) cause of action is misrepresentation, i.e., the omission or misstatement of material facts."²³² The determinations of other federal courts that the *Santa Fe* definition of "manipulation" applies to Section 14(e) further buttress the *Buffalo Forge* interpretation of the term. The same precedent undermines the *Mobil* claim that Section 14(e) "manipulation" can occur in the absence of misrepresentation or nondisclosure.²³³

In constructing a rationale for its decision, the *Mobil* court understandably avoided the passage in *Santa Fe* in which the Court held that misrepresentation or nondisclosure is necessary to "manipulative conduct." Instead, the Sixth Circuit relied on statements in *Ernst & Ernst v. Hochfelder*²³⁴ and *Santa Fe* to the effect that "manipulation" meant tactics which "artificially affect" stock prices.²³⁵ The court based its

228. See *Panter v. Marshall Field & Co.*, 646 F.2d 271 (7th Cir. 1981), *cert. denied*, 454 U.S. 1092 (1981); *Berman v. Gerber Prods. Co.*, 454 F. Supp. 1310 (W.D. Mich. 1978); *Altman v. Knight*, 431 F. Supp. 309 (S.D.N.Y. 1977).

229. 646 F.2d 271 (7th Cir. 1981), *cert. denied*, 454 U.S. 1092 (1981).

230. *Id.* at 282.

231. *Id.* at 283. For other cases holding that misrepresentation or nondisclosure is a required element of a § 14(e) violation, see *Atchley v. Qonaar Corp.*, 704 F.2d 355, 358 (7th Cir. 1983); *Martin-Marietta Corp. v. Bendix Corp.*, 549 F. Supp. 623, 628 (D. Md. 1982); *Lewis v. McGraw*, 619 F.2d 192, 195 (2d Cir.), *cert. denied*, 449 U.S. 951 (1980); *Berman v. Gerber Prods. Co.*, 454 F. Supp. 1310, 1318 (W.D. Mich. 1978); *Chris-Craft Indus., Inc. v. Piper*, 480 F.2d 341, 362 (2d Cir. 1973), *cert. denied*, 414 U.S. 910 (1973).

232. 717 F.2d at 760.

233. 669 F.2d at 376.

234. 425 U.S. 185, *reh'g denied*, 425 U.S. 986 (1976).

235. 669 F.2d at 374. The Sixth Circuit cited the following passages in support of its position:

Use of the word manipulative is especially significant. It is and was virtually a term of art when used in connection with securities markets. It connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities.

Ernst & Ernst, 425 U.S. at 199.

Manipulation is "virtually a term of art when used in connection with securities markets." *Ernst & Ernst*, 425 U.S. at 199. The term refers generally to practices, such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity.

Santa Fe, 430 U.S. at 476. These two passages clearly indicate that the Supreme Court defines "manipulation" in the securities context as conduct involving some element of fraud or deception.

holding that neither misrepresentation nor nondisclosure is an essential element of Section 14(e) "manipulation" on *Cargill, Inc. v. Hardin*,²³⁶ a case interpreting the meaning of "manipulation" in the context of commodities futures trading.²³⁷

The Sixth Circuit's attempt to base its holding on the "artificial effect" theory of "manipulation" is untenable for three reasons. First, the court ignored language in the very passages it cites from *Ernst* and *Santa Fe* which explains that the term "manipulation" contemplates conduct intended to "artificially affect" stock prices by *deceiving* or *misleading* investors *as to the true value* of the securities.²³⁸ The grant of the options to U.S. Steel served not to mislead investors as to the value of Marathon stock, but to elicit a tender offer for that stock at a price \$40 per share higher than the Mobil offer.

Second, *Mobil's* reliance on *Cargill* is totally misplaced. *Ernst*, as *Mobil* itself points out,²³⁹ establishes that "manipulation" is a "term of art when used in connection with securities markets."²⁴⁰ Given this specialized use of the term, the interpretation of "manipulation" in *Cargill*, a commodities case, is irrelevant to the meaning of the term as used in the securities laws.²⁴¹

Finally, the tactics described as "manipulative" in *Ernst* and *Santa Fe* are only those which artificially affect "market activity."²⁴² The Court in these cases was referring only to activities in the stock market which create the illusion of demand for a particular stock.²⁴³ There

The examples of "manipulative devices" given in *Santa Fe* are all deceptive stock trading devices. This indicates that "manipulative" activities are conduct in the stock market which creates a false impression as to the value of a stock. A lock-up agreement between a target company and a "White Knight" creates no such false impression as to the value of the target stock.

236. 452 F.2d 1154 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972).

237. *Id.* at 1163.

238. *See supra*, note 233.

239. 669 F.2d at 374.

240. 425 U.S. at 199.

241. *Cargill* provides an excellent description of the functioning of the commodities future exchanges, and explains that the purpose of federal regulation of these exchanges is to assure farmers an adequate price for their produce, thereby protecting consumers against food shortages. *Cargill*, 452 F.2d at 1156-63. The federal securities laws differ from the commodities laws in that they seek not to regulate securities prices, but to ensure the integrity of the securities markets through the prevention of fraud. Therefore, the meaning of the term "manipulation" in securities law is completely unrelated to its meaning in commodities law.

242. The "wash sales, matched orders, or rigged prices" cited in *Santa Fe* as "manipulative" are all tactics employed in the stock market to create the illusion of trading activity in a stock.

243. *See Hundahl v. United Benefit Life Ins. Co.*, 465 F. Supp. 1349 (N.D. Tex. 1979), in which the court, after examining the legislative history and Supreme Court interpretations of the term, concluded that "manipulation" means: "practices in the market place which have the effect of either creating the false impression that certain market activity is occurring when in fact such activity is unrelated to actual supply and demand or tampering with the price itself . . ." *Id.* at 1360.

was no stock market activity involved in the grant of the options by Marathon to U.S. Steel, and it created no unfounded illusions as to the demand for or value of Marathon stock. Therefore, the options were not "manipulative" acts under Section 14(e).

D. Practical Effects of Mobil and Buffalo Forge on Tender Offer Defensive Tactics

Buffalo Forge represents the inevitable culmination of widespread judicial discomfort with the potentially far-reaching implications of *Mobil*.²⁴⁴ The Second Circuit's decision reaffirms the prevailing judicial consensus that the Williams Act is solely a disclosure statute, and marks a return to application of the Act in a manner consistent with that purpose. Moreover, *Buffalo Forge* helps to reestablish the boundary between state and federal areas of corporate regulation by adhering to the *Santa Fe* command that complaints relating to the substantive fairness of transactions are to be dealt with under the applicable state law of fiduciary duties.

The Second Circuit's unequivocal holding that the Williams Act requires only full disclosure establishes a clear standard for compliance with Section 14(e). The decision assures corporate directors that defenses to tender offers are valid under federal law as long as they are fully disclosed. Furthermore, the Second Circuit makes it clear that the standards of substantive fairness to which defense tactics must conform are those established by state law.

The well-defined standard for compliance emerging from *Buffalo Forge* is a welcome contrast to the uncertainty wrought by *Mobil*. The Sixth Circuit's holding would allow the invalidation of target responses to tender offers merely because a particular judge feels the transaction is unfair. This open-ended judicial license would make the imposition of Section 14(e) liability entirely unpredictable and dependent on the predilections of individual judges. Such a capricious standard would undermine the well-established norms of directorial conduct embodied

244. The trepidation with which *Mobil* was received is evident in the first cases dealing with claims based on the Sixth Circuit's interpretation of § 14(e). Initially, courts sought either to avoid the § 14(e) issue altogether, or to factually distinguish their cases from *Mobil*. See *Cities Service Co. v. Mesa Petroleum Co.*, 541 F. Supp. 1220 (D. Del., 1982); *Whittaker Corp. v. Edgar*, 535 F. Supp. 933 (N.D. Ill. 1982). This trepidation soon blossomed into outright hostility, as courts began to reject *Mobil*-based arguments that § 14(e) can be violated in the absence of misrepresentation or nondisclosure. See *Marshall Field & Co., v. Icahn*, 537 F. Supp. 413 (S.D.N.Y. 1982); *Martin-Marietta Corp. v. Bendix Corp.*, 549 F. Supp. 623 (D. Md. 1982); *Schreiber v. Burlington Northern, Inc.*, 568 F. Supp. 197 (D. Del. 1983); *Swanson v. Wabash, Inc.*, 577 F. Supp. 1308 (N.D. Ill. 1983). Only the Ninth Circuit has endorsed the *Mobil* view of § 14(e). See *Pacific Realty v. APC Investments, Inc.*, 685 F.2d 1083, 1086 (9th Cir. 1982).

in the fiduciary duties established by state law.²⁴⁵

Although the Sixth Circuit did not premise its *Mobil* ruling on the inadequacy of state law remedies, some commentators attempt to justify *Mobil* as the necessary response to an asserted failure of state courts to protect public shareholders from abuses of corporate power by directors seeking to stave off tender offers.²⁴⁶ This argument is based on the perception that the interest of target directors in preserving their power will preclude them from exercising objective business judgment in determining the proper response to a tender offer which threatens that power.²⁴⁷ It is argued that this conflict of interest renders the business judgment rule inapplicable to the decisions of target directors to undertake defensive measures against a tender offer.²⁴⁸ This argument is fueled by the hesitancy of some courts applying the business judgment rule in tender offer cases to thoroughly examine the fairness of defensive tactics to target shareholders.²⁴⁹

245. State law imposes on directors duties of care and loyalty to the corporations they manage. The duty of care requires that directors exercise the same degree of care in the discharge of their corporate duties as a reasonable person would employ in the management of personal affairs. The duty of loyalty bars a director from competing with their corporations, appropriating opportunities which rightfully belong to their corporations, and from entering transactions in which their interests unfairly conflict with those of their corporations. If a court finds that a director has complied with these duties, the business judgment rule bars further judicial scrutiny of the directors conduct. HENN & ALEXANDER, *LAWS OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES*, 621-63 (3d ed. 1983).

246. See Weiss, *Defensive Responses to Tender Offers and the Williams Act's Prohibition Against Manipulation*, 35 VAND. L. REV. 1087 (1982); Lynch & Steinberg, *The Legitimacy of Defensive Tactics in Tender Offers*, 64 CORNELL L. REV. 901 (1979); Comment, *Target Defensive Tactics as Manipulative Under Section 14(e)*, 84 COLUM. L. REV. 228 (1984).

247. It is true that the interest of a corporate director in keeping his job will often diverge with the interest of a shareholder in maximizing the return on his investment. See Harrington, *If it Ain't Broke, Don't Fix it: The Legal Propriety of Defenses Against Hostile Takeover Bids*, 34 SYR. L. REV. 977, 989 (1983); Comment, *The Misapplication of the Business Judgment Rule in Contests for Corporate Control*, 76 N.W.U.L. REV. 980 (1982); Comment, *Tender Offer Defensive Tactics and the Business Judgment Rule*, 58 N.Y.U.L. REV. 621, 652 (1983).

248. See Weiss, *supra* note 244, Lynch & Steinberg, *supra* note 244. Other commentators, while not advocating the use of § 14(e) to remedy unfair tender offer dealings, agree that the business judgment rule has been misapplied in the tender offer context. See Harrington, *If it Ain't Broke, Don't Fix it: The Legal Propriety of Defenses Against Hostile Takeover Bids*, 34 SYR. L. REV. 977 (1983). Professor Harrington points out that the business judgment rule applies only to transactions in which the directors have no personal interest. *Id.* at 1021. This prerequisite of disinterestedness, according to Harrington, is not met in corporate takeover situations because the actions of the target directors are tainted by their interest in preserving their jobs. *Id.* at 1021-22. Harrington would deny the protections of the business judgment rule to target directors in takeover situations, and require that they prove that actions which served to maintain their control were intended primarily to serve the interests of the corporation, and were fair to the shareholders. *Id.* at 989, 1022-23. See also, Comment, *Tender Offer Defensive Tactics and the Business Judgment Rule*, 58 N.Y.U.L. REV. 621, 655-57 (1983); Comment, *The Misapplication of the Business Judgment Rule in Contests for Corporate Control*, 76 N.W.U.L. REV. 980 (1982).

249. See *Whittaker Corp. v. Edgar*, 535 F. Supp. 933, 950 (N.D. Ill. 1982); *Panther v. Marshall Field & Co.*, 646 F.2d 271, 293 (7th Cir.), *cert. denied*, 454 U.S. 1092 (1981); *Johnson v. Trueblood*, 629 F.2d 287 (3d Cir. 1980), *cert. denied*, 450 U.S. 999 (1981); *Cheff v. Mathes*, 199 A.2d 548 (Del.

Contrary to the urgings of those who would abandon state law in tender offer jurisprudence, courts applying state fiduciary standards have begun to recognize the inherent conflict of interest of a corporate director faced with a threat to his or her position and power.²⁵⁰ Decisions under state law have uniformly held that a director's use of corporate resources and power for the sole purpose of perpetuating or preserving his or her control of the corporation is a breach of fiduciary duty.²⁵¹ Although the standards by which the various states will evaluate the defensive tactics employed by target directors in tender offer battles are still evolving, recent cases have subjected the conduct of directors in transactions affecting corporate control to more rigorous examination.²⁵²

An example of the increased vigilance of the state courts on behalf of shareholders is *Singer v. Magnavox Co.*²⁵³ There, the Delaware

1964). A recent decision of the Delaware Supreme Court demonstrates that the mere recitation of the business judgment rule does not necessarily afford directors talismanic protection from judicial scrutiny. See *Smith v. Van Gorkom*, Del. Sup. Ct. Slip. Op. No. 255 (Jan. 29, 1985). There, the court denied the protections of the business judgment rule to a board decision to agree to a takeover of the corporation. *Id.* at p.63. The court based this denial on the failure of the directors to adequately inform themselves of all material information before consenting to the takeover. *Id.*

250. See *Crane Co. v. Harsco Corp.*, 511 F. Supp. 294, 305 (D. Del. 1981); *Northwest Indus., Inc. v. B.F. Goodrich Co.*, 301 F. Supp. 706, 712 (N.D. Ill. 1969); *Treadway Cos., Inc. v. Care Corp.*, 638 F.2d 357, 382 (2d Cir. 1980); *Bennett v. Propp*, 187 A.2d 405, 409 (Del. 1962).

251. *Condec Corp. v. Lunkenheimer Co.*, 43 Del. Ch. 353, 230 A.2d 769 (1967) (issuance of stock to friendly party for sole purpose of defeating tender offer held to breach fiduciary duty); *Cheff v. Mathes*, 199 A.2d 548 (Del. 1964); *Bennett v. Propp*, 187 A.2d 405, 408 (repurchase of stock for sole purpose of maintaining control of corporation is improper); *Singer v. Magnavox Co.*, 380 A.2d 969, 979-80 (Del. 1977); *Crane Co. v. Harsco Corp.*, 511 F. Supp. 294, 305 (D. Del. 1981).

252. Originally, actions of directors in resistance to a takeover were sheltered by the business judgment rule unless the plaintiff could show that the "sole" or "primary" purpose of the directors' acts was to maintain control. See *Cheff v. Mathes*, 199 A.2d at 554, *Northwest Indus., Inc. v. B.F. Goodrich Co.*, 301 F. Supp. 706, 712 (N.D. Ill. 1969); *Whittaker Corp. v. Edgar*, 535 F. Supp. 933, 950 (N.D. Ill. 1982); *Panter v. Marshall Field & Co.*, 646 F.2d 271, 297 (7th Cir.), *cert. denied*, 454 U.S. 1092 (1981). Another line of cases requires that the directors prove that transactions enhancing their control of the corporation were entered for valid business reasons. See *Bennett v. Propp*, 187 A.2d at 409; *Treadway Cos. v. Care Corp.*, 638 F.2d at 382; *Crouse-Hinds Co. v. Internorth, Inc.*, 634 F.2d 690, 702 (2d Cir. 1980); *Crane Co. v. Harsco Corp.*, 511 F. Supp. at 305. In practice, directors were able to satisfy these standards with little more than a recitation of some plausible business reason for actions clearly intended to avert a takeover. See Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663 (1974). Some recent cases, however, have imposed a higher standard, requiring that directors show more than an arguable business reason for transactions which preserve their positions. These cases demand that directors prove the "entire fairness" of such transactions to the corporation and its shareholders. See *Klaus v. Hi-Shear Corp.*, 528 F.2d 225 (9th Cir. 1975); *Singer v. Magnavox Co.*, 380 A.2d 969, 980 (Del. 1977); *Tanzer v. International General Indus., Inc.*, 379 A.2d 1121 (Del. 1977); *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983); *but see Lynch v. Vickers Energy Corp.*, 402 A.2d 5 (Del. Ch. 1979) (holding that fiduciary duty of majority shareholders to minority is not as great in connection with tender offer by majority for minority's stock as it is in "cash-out" merger where minority is legally compelled to sell out).

253. 380 A.2d 969 (Del. 1977). This case was decided in the wake of the Supreme Court's

Supreme Court announced that, where directors are interested in a transaction affecting corporate control, the directors will have to establish the "entire fairness" of the transaction to all shareholders.²⁵⁴ Applied to tender offer defenses, such a standard would prevent tactics which entrench incumbent management at the expense of shareholders, while freeing directors to resist tender offers which are inimical to the interests of the corporation and its shareholders.²⁵⁵ This flexible, comprehensive standard is preferable to *Mobil's* blanket prohibition of all tactics which tend to deter a particular tender offer.

The recent application of New York law by the Second Circuit in *Norlin Corp. v. Rooney, Pace, Inc.*²⁵⁶ provides further evidence of the capacity of state law to protect shareholders in a takeover dispute. At issue in *Norlin* was the legality of the use of an employee stock ownership plan as a method of averting an impending takeover.²⁵⁷ After the purchase of blocks of Norlin stock by a group apparently poised to launch an attempt to acquire control of the company, the Norlin board established an employee stock ownership plan ("ESOP"), and transferred a large number of authorized but unissued Norlin shares to the ESOP.²⁵⁸ The effect of this transaction was to insulate the shares issued to the ESOP from acquisition by the takeover bidder.²⁵⁹

The Norlin directors sought to preclude judicial scrutiny of the ESOP tactic by interposing the business judgment rule.²⁶⁰ The Second Circuit responded that state law imposes on corporate directors both a duty of care and a duty of loyalty, and held that the business judgment rule applies only where the duty of care is at issue.²⁶¹ The court stated that a challenge to a transaction in which directors have a personal interest implicates the duty of loyalty, which requires that the directors prove that "the transaction is fair and serves the best interests of the corporation."²⁶² The Second Circuit recognized that directors con-

pronouncement in *Santa Fe* that the substantive fairness of corporate transactions is to be regulated by the states, and indicates that Delaware intends to provide more effective protection to shareholders in this area.

254. *Id.* at 980.

255. The courts agree that corporate directors have a duty to resist takeovers which would be detrimental to their corporations and shareholders. See *infra* text accompanying notes 271-78.

256. 744 F.2d 255 (2d. cir. 1984).

257. *Id.* at 258.

258. *Id.* The directors retained voting control over the stock issued to the ESOP. *Id.* at 259. After the issuance of stock to the ESOP, which gave no real consideration for the shares, the directors controlled 49% of the outstanding stock of Norlin. *Id.*

259. *Id.* at 258.

260. *Id.* at 264.

261. *Id.*

262. *Id.*

fronted with a potential takeover are personally interested in transactions which serve to solidify their control, and held that the duty of loyalty sets the standard for judicial review of such transactions.²⁶³ Because the transfer of stock to the ESOP served to solidify the Norlin Board's control, the burden shifted to the directors to prove that the transaction comported with the duty of loyalty.²⁶⁴

The court held that the duty of loyalty required that the Norlin directors show that the ESOP was "fair and serve[d] the best interests of the corporation and its shareholders."²⁶⁵ Because the directors did not prove that the ESOP served any purpose other than the perpetuation of their control, the court found that the directors failed to meet this burden.²⁶⁶ Accordingly, the court enjoined the Norlin board from voting the ESOP stock.²⁶⁷

The *Norlin* analysis is a cogent demonstration of the viability of state fiduciary standards as safeguards for shareholders involved in a takeover. This standard would protect shareholders from abuses of power by target directors, while allowing directors to use proper methods to resist harmful takeovers. Such an approach is clearly preferable to the virtually standardless review propounded by *Mobil*.

The broad language of *Mobil* raised fears in many that all defenses to tender offers could be outlawed under the Williams Act.²⁶⁸ Recog-

263. *Id.* at 265.

264. In holding that the burden of proving the fairness of the ESOP properly fell on the directors, the court held that considerations relevant to a target board's determination that a particular takeover would be harmful to the corporation do not justify all the tactics employed to defeat that takeover. *Id.* at 267. Accordingly, the court rejected the boards' contention that, once it had determined that the takeover would hurt Norlin, all actions it deemed necessary to avert the takeover were permissible. *Id.* at 265-66. Similarly, the court held that matters such as the takeover bidder's reputation for rapacity and the board's fear that the takeover would hurt one of Norlin's businesses and jeopardize a valuable tax loss carryforward, while germane to the validity of the board's decision to oppose the takeover as a general proposition, were irrelevant to the propriety of the decision to employ the ESOP tactic. *Id.* at 267.

265. *Id.* at 266.

266. *Id.* The court emphasized that a board of directors may not use corporate resources for the sole purpose of entrenching themselves in their positions. Under the duty of loyalty analysis, directors must show that transactions which serve to solidify their control have a legitimate purpose beyond that effect. Observing that the ESOP had the effect of enhancing the directors' control, the court held that the establishment of the ESOP would be permissible only if it also furthered the legitimate purpose of benefitting employees. *Id.*

267. *Id.* at 267. Another interesting recent state decision which deals directly with the propriety of lock-up options is *Thompson v. Enstar*, Civil Action #7641 (Del. Ct. Chan.) (Slip op. 6/20/84). There, the Delaware Court of Chancery recognized that lock-ups often deprive shareholders of the benefits of open bidding by competing takeover candidates, and often infringe the voting rights of shareholders. *Id.* at p.6. The court held that these effects warrant careful judicial scrutiny of lock-ups in order to ensure that "under all the facts and circumstances existing in a particular case they are fair to the shareholders." *Id.*

268. See Prentice, *Target Board Abuse of Defensive Tactics: Can Federal Law be Mobilized to Overcome the Business Judgment Rule?*, 8 J. CORP. L. 337, 356 (1983).

nizing the likelihood that the Sixth Circuit's interpretation of Section 14(e) would hamstring target directors, courts²⁶⁹ and commentators²⁷⁰ alike have criticized *Mobil* as an unprecedented judicial intrusion into corporate decision-making. The possibility that Section 14(e) liability would attach to any action which a judge feels is unfair to shareholders or competing tender offerors would cause target directors to eschew any defensive response to a tender offer. Thus, *Mobil* would take control of corporate destiny away from the elected directors of a company as soon as it becomes the target of a tender offer.

The *Mobil* decision has ramifications beyond forcing directorial abdication upon the initiation of a tender offer. *Mobil* would effectively ban resistance to any tender offer, regardless of whether or not such passivity is in the best interests of the target company.²⁷¹ This requirement directly conflicts with a director's state law fiduciary duty to resist takeovers which would be bad for the corporation.²⁷² Under *Mobil's* reading of Section 14(e), target directors could be subject to liability regardless of the fact that their decision to oppose a tender offer was based on their sound business judgment that the offer was contrary to the best interests of the company.

Mobil's effect on the ability of target management to fend off potentially harmful takeovers has not gone unnoticed.²⁷³ The Southern District of New York, in *Marshall Field v. Icahn*²⁷⁴ recognized that *Mobil* would preclude directors from fulfilling their fiduciary duty to resist such takeovers.²⁷⁵ The court rejected a *Mobil*-based argument that a target company defensive measure was prohibited by Section 14(e).²⁷⁶ Refusing to follow *Mobil*, the court said, "In my view the securities laws do not bar management from taking action in the best interests of its shareholders even if this will make more difficult the success of a

269. *Marshall Field & Co. v. Icahn*, 537 F. Supp. 413 (S.D.N.Y. 1982) rejected *Mobil* as an improper restriction on corporate directors' freedom of action. *Id.* at 422.

270. See Prentice, *supra* note 254.

271. Prentice warns that "the [*Mobil*] decision does not take into account the circumstances in which defensive tactics are in the best interests of the target shareholders." *Id.* at 357.

272. See Note, *Tender Offer Defensive Tactics and the Business Judgment Rule*, 58 N.Y.U.L. REV. 621 (1983), which describes the dilemma of target directors faced with a tender offer which they believe to be contrary to the best interests of their shareholders as "Hobson's Choice" after *Mobil*. If they choose not to resist the offer, they will violate their fiduciary duty to resist takeovers which appear to be harmful. Resistance, however, would put the directors in violation of § 14(e), according to *Mobil*. *Id.* at 650.

273. According to Prentice: "The *Mobil* decision does not give the target board room to act in the shareholder's best interests." Prentice, *supra*, note 254 at 358.

274. 537 F. Supp. 413 (S.D.N.Y. 1982).

275. *Id.* at 422.

276. *Id.*

disfavored offeror."²⁷⁷

Courts have long recognized the duty of corporate directors to resist takeovers they feel are contrary to the best interests of the corporation and its shareholders.²⁷⁸ The *Mobil* demand that directors remain passive in the face of such offers is irreconcilable with this well-established duty.²⁷⁹ It is inconceivable that in passing the Williams Act, Congress intended to place corporate management in such a dilemma.

Buffalo Forge offers a way out of this predicament. By returning to the long standing construction of the Williams Act as solely a disclosure law,²⁸⁰ the Second Circuit allows target management to comply with the statute and fulfill its duty to resist harmful takeovers. Under *Buffalo Forge*, directors are assured that any steps taken to fight off a hostile tender offer will be valid under Section 14(e) as long as they are fully disclosed.²⁸¹ In the event that a tender offer is in the best interests of corporate shareholders, directors remain free under *Buffalo Forge* to acquiesce in the takeover.

V. CONCLUSION

The Second and Third Circuits have returned to the accepted principles of application of the Williams Act. They reject *Mobil's* improper use of Section 14(e) as an all-purpose tool to undo corporate control transfers which a particular judge feels are unfair. The *Buffalo Forge* holding that a fully disclosed defensive response to a tender offer is permissible under Section 14(e) is consistent with Congress' intent that the Williams Act serve only as a disclosure statute.

Furthermore, *Buffalo Forge* and *Schreiber* repair the damage done by *Mobil* to the fences separating the federal and state fields of corporate regulation. These two decisions reaffirm state jurisdiction over

277. *Id.*

278. See *Heit v. Baird*, 567 F.2d 1157 (1st Cir. 1977), in which the court stated ". . . management has not only the right but the duty to resist by all lawful means persons whose attempt to win control of the corporation, if successful, would harm the corporate enterprise." *Id.* at 1161. See also *Panter v. Marshall Field & Co.*, 646 F.2d at 297; *Berman v. Gerber Prods. Co.*, 454 F. Supp. at 1319.

279. The relative economic merits of tender offers and defensive tactics is the subject of much scholarly debate, but is beyond the scope of this article. For opposing views on these issues see Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, (1981); Easterbrook & Fischel, *Takeover Bids, Defensive Tactics and Shareholder's Welfare*, 36 BUS. LAW. 1733 (1981); Fischel, *The Legal Regulation of Tender Offers*, INST. ON SEC. REG., Ann. 1981; and Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW 101 (1979). See also Comment, *The Case for Facilitating Competing Tender Offers*, 95 HARV. L. REV. 1028 (1982).

280. 717 F.2d at 760.

281. See *id.*

claims of breach of fiduciary duty, and confine federal law to its traditional role of monitoring disclosure in tender offer battles. This tempers the potentially profound impact of *Mobil* on state corporate law.

Perhaps most importantly, directors of target companies are now freed of the dilemma created by *Mobil*. Confronted with a tender offer, corporate management will now be able to fulfill its duty to take such action as it determines is in the best interests of the corporation. Should these interests call for resistance to the tender offer, directors are assured that if fully disclosed, such measures will not run afoul of the Williams Act. A vigorous application of the emerging state standards of directorial conduct in tender offers will safeguard shareholders in situations where defensive tactics are contrary to their interests.